Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of:	)	
	)	
Implementation of Section 621 (a)(1) of the Cable	)	MB Docket No. 05-311
Communications Policy Act of 1984 as amended	)	
By the Cable Television Consumer Protection and	)	
Competition Act of 1992	)	
	)	

Comments of the American Consumer Institute

INTRODUCTION AND SUMMARY

The American Consumer Institute ("Institute") hereby submits comments in response to the Federal Communications Commission ("FCC") *Notice of Proposed Rulemaking* ("NPRM") in the above-captioned proceeding.

The American Consumer Institute is an independent organization with no financial ties to any party in this proceeding. Founded in 2005 the Institute's mission is to identify, analyze and project the interests of consumers in selected legislative and rulemaking proceedings in information technology, health care, commerce and other matters. Recognizing that consumers' interests can be variously defined and estimated, the goal of the Institute is to bring to bear the tools of economic and consumer welfare analyses as rigorous as available data will allow, while taking care to assure that the analyses reflects relevant and significant costs and benefits.

We are especially sensitive to distant, collateral, or indirect, but nonetheless important costs or benefits that are frequently ignored or misstated by consumer advocates. For this reason, we believe that consumers' interests are from time to time inaccurately or incompletely represented in FCC rulemaking proceedings. Our intention is to address that gap, make clear our approach and the basis for differences, then to invite other stakeholders to evaluate our success in doing so.

The Commission's statutory guidance in Section 621(a)(1) of the Act is clear and compelling: "…a franchising authority … may not unreasonably refuse to award an additional competitive franchise."[1] In that context our comments address specific Commission solicitations in the NPRM:

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[1] 47 U.S.C. § 541(a)(1).

- "…whether the franchising process unreasonably impedes the achievement of the interrelated federal goals of enhanced cable competition and accelerated broadband deployment…"

- "…what constitutes an unreasonable refusal to award an additional competitive franchise under Section 621(a)(1)."[2]

- "…how the Commission should act to address that problem."[3]

We conclude that the number and diversity of local franchising authorities and processes that must be satisfied by potential new entrants into the market for multichannel video program distribution ("MVPD") services taken together do in fact constitute a very substantial barrier to entry and impede the development of competition; tend to deny and delay consumer's choice; raise consumer rates paid by consumers; increase the cost of capital to potential entrants; and, generally, frustrate national, statutory goals of accelerating the deployment of broadband technologies in local markets.

These effects are of more than an academic concern. A recent study of the Institute found that the absence of wireline cable TV competition costs consumers billions of dollars annually and, over the next five years, in excess of $1,100 per household for seniors. FCC has reported that cable prices increases have averaged 7.5% per year over a recent 5-year period, and shown that price per channel was 27% lower in markets with wireline competition.[4]

However, competition is far from imminent. According to a survey of 1,000 consumers nationwide, the Institute found that nearly 80% of cable consumers wanted more competition, and 70% felt they were paying too much for cable services.[5] Behind this apparent discontent is the lack of competition – namely, the fact that wireline overbuilders have a 1.8% share of the MVPD market.[6]

For these general reasons, we urge the Commission to exercise its power, by either specific rule or guidance, to implement Section 621(a)(1)'s directive that local franchise authorities ("LFAs") not unreasonably refuse to award competitive franchises.[7]

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[2] NPRM, p. 11.
[3] NPRM, p. 2.
[4] An FCC report shows that the competitive benefits from wireline competition far exceeds the benefits from satellite and other video providers. "Report on Cable Industry Prices," FCC, MM Docket No. 92-266, released Feb. 4, 2005.
[5] "Consumer Pulse Survey: 2006," The American Consumer Institute, January 2006.
[6] Ibid.
[7] We have noted well the Commission's tentative determination that it has such power and its solicitation in the NPRM of the views of parties on the depth and scope of that power. Pending the Commission's final determination of its authority, we limit our recommendations to a broad sketch of the content of potential guidance and or specific rules

DISCUSSION

We call the attention of the Commission to the economic context within which these questions ought to be considered. First, it is well established that barriers to entry from whatever source will generally: a) increase the economic rents of the incumbent;[8] b) deny consumers alternatives; and c) raise the prices paid by end users.[9] It is also obvious from casual inspection of widespread government practice that barriers to entry do originate with federal, state or local rules requiring licensing, franchising, access to public property or other forms of government action. Finally, it is well established that private parties have an incentive to use government action to protect market positions; to create and perpetuate entry barriers; and otherwise to encourage government action as a form of "rent seeking."[10]

Franchising Practices Delay Competition in MVPD Services Market

Franchises are by definition and effect a barrier to entry imposed by government. As such they delay the introduction of new technology, new firms, alternative service offerings and through that directly reduce consumer choice.

The requirement to negotiate with local authorities, and the restrictions that typically result, delay the entry of would-be rivals into the MVPD services market, and, by association, the broadband market. The NPRM cites would-be competitors waiting up to three years for regulatory approval to enter the MVPD market.[11] Even a few months of delay would confer advantages to entrenched cable monopolists. An incumbent might rationally be expected to use that time to take actions that lock-in consumers and discourage them from switching to new, lower cost MVPD service competitors. The presence of an incumbent cable operator during negotiations, invites an adversarial atmosphere that leads to interference, lengthens the approval process, and adds requirements to entry. These costs, whether opportunity costs, barriers to entry, or monetary – all are ultimately borne in one form or another by consumers.

Since potential entrants and competitors must first receive regulatory approval of a local franchise agreement in order to enter any market, the cost and delay of negotiating numerous (34,000 nationwide) unique franchise agreements guarantees that substantial and variable delay for firms wishing to build out statewide, regional and/or national

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[8] See Richard J. Gilbert, "Mobility Barriers and the Value of Incumbency", Handbook of Industrial Organization, Volume I, R. Schmalansee and R.D. Willig eds., Elsevier Science Publishers, 1989, pp. 475-535 and voluminous references cited there.

[9] For good review of the theory and evidence on the relationship between entry barriers, concentration and prices see Donald A. Hay and Derek J. Morris, Industrial Economics and Organization: Theory and Evidence, Oxford University Press, 1991 Chapter 8, "Market Structure and Profitability", especially pp. 224-227 and pp. 259-261.

[10] See James M. Buchanan, Robert D. Tollison and Gordon Tullock, eds., Toward a Theory of the Rent-Seeking Society, College Station: Texas A&M Press, 1980.

[11] NPRM, pp. 506, fn. 28.

networks.[12] The result is to delay realization of important consumer benefits from the availability of alternative supply for video and broadband services. Imposing time limits on the negotiation process would deal partly with the cost of delay, but it would not address other costs, such the many unnecessary regulatory obligations that find their way into franchise agreements (to be discussed later in these comments), as well as the potential administrative benefits of establishing universal terms and conditions across the nation.

Franchise Provisions Raise Potential Rivals' Costs

Franchising requirements imposed on new entrants have the effect of raising rivals' costs, which in the context of the market conduct of private firms has been considered widely as a source of potential antitrust violation.[13] That said, it is important to recognize that franchises are not without redeeming benefits they may in fact confer on some. For example, franchise agreements reached with LFAs typically include provisions for franchise fees and public, educational and government access support, and free connections and service to government buildings, as well as free city advertising. Agreements sometimes require cable operators to give local governments free equipment, including converters, optical devises, cameras, and scrambling devises.[14] Other agreements sometimes require franchisees to provide loans and grants to disadvantaged businesses, and scholarships for students.[15] Many agreements require construction of institutional networks capable of providing much more than video services – including voice and high-speed data services. Getting a franchise may require planting 20,000 trees, construction projects and job training programs.[16] These examples reflect known obligations reflected in various franchise agreements. We do not know what egregious requirements, if any, were dropped during lengthy negotiations.

Another franchise-related cost is the imposition of stricter rights-of-way (ROW) provisions on firms that already have access to the local ROW as franchised telecommunications providers.[17] It is not clear how consumers benefit from adding local ROW obligations on top of state obligations, when most cable TV providers use their networks to jointly provide video, voice and broadband services. One report has cited

[12] Kent Lassman, "Franchising in the Local Communications Market: A Primer and Discussion of Three Questions," The Progress and Freedom Foundation, Progress on Point Release 12.9, Washington, DC, June 2005.

[13] S. Salop and D. Scheffman, "Raising Rivals Cost", *American Economic Review Papers and Proceedings*, (1983), pp.267-281. This article discusses how firms can raise rivals cost and thereby deter or reduce the effectiveness of new entry.

[14] This is the "2005 Franchise Agreement Between the City of Iowa City and MCC Iowa LLC (Mediacom)."

[15] "Cable Television Franchise Agreement Between the City of Milwaukee and Time Warner Cable of Southeastern Wisconsin, L.P.," approved Dec. 17, 1999.

[16] Thomas W. Hazlett, "Wiring the Constitution for Cable," CATO Institute, Washington, DC, (available at http://www.cato.org/pubs/regulation/regv12n1/reg12n1-hazlett.html).

[17] Some evidence suggests that local rights-of-way management is more costly for consumers, compared to statewide rights-of-way management. See, "Wrong Way for Right-of-Way?" Public Policy Bulletin, TeleNomic Research, Herndon, VA, 1st Quarter, 2006.

two-year delays in obtaining local municipal permits for broadband construction.[18] In another instance, LFA authorities denied permits for network construction, because it was capable of providing video services, even though state authorities would have granted permits for similar construction as a telecommunications service.[19] As a result, investment did not occur in this municipality and consumers did not see competition.[20]

These franchisee obligations are illustrative only. We are aware of others and expect that the record in this proceeding will in due course reflect a litany of local requirements imposed as a part of a "quid pro quo" with local franchising authorities. All such obligations impose costs, in the first instance, on licensees. While most of these obligations may confer some benefit to some classes of citizens, or special interests, and thus may have some public value, an alarming number of them have little to do with the provision of efficient, low cost MVPD services, which are in the first instance the focus of the license and, most importantly, the specific economic activity which there is a federal interest in promoting.

Franchising Delays Discourage Investment

The consequences of the slow pace of the LFA process – namely, impeding investment and raising operational costs – are not trivial and realized by potential entrants in a variety of ways. Notably, the franchising processes are regarded by Wall Street telecommunications equity analysts and investors in telecommunications securities as a major risk in the business plans of would-be competitors. For example, analysts at Lehman Brothers conclude without reservation that that LFA actions will ultimately undermine the business case for planned investments by AT&T and Verizon. Thus:

> "Verizon will have limited success signing up customers in the few markets where it video offering is available and may significantly scale back its FiOS initiative due to poor economics and the ongoing difficulties associated with obtaining video franchises.[21]
> "[W]e believe political pressure from both the municipalities and incumbent cable companies will make it extremely difficult for the RBOCs to gain significant regulatory relief from the states. We expect the hard work of receiving franchises on a piecemeal basis will continue and materially restrict the availability of both AT&T's and Verizon's video offerings."[22]

Analysts emphasized the high financial risks of a mass rollout of consumer video and broadband services, adding that a national video franchise policy would be "one key swing factor" in the assessment of these risks."[23] Since new entrants are building high-

[18] Broadband Deployment in California, California Public Utilities Commission, Sections 6.2.2, May 5, 2005. For a general discussion about varying fees and delays see Sections 6.2.1 through 6.2.3.
[19] Linda Haugsted, "SBC Hits a Pothole in California," *Multichannel News*, Oct. 31, 2005.
[20] Ibid.
[21] Bath Blake and Thomas Seitz, "Telecom Services – Wireline," Lehman Brothers, January 4, 2006, p. 18.
[22] Ibid.
[23] Marcus Kupferschmidt, "Emerging Telecom Technologies," Lehman Brothers, January 4, 2006, p. 1.

speed networks that provide video and cable TV services, and since the Telecommunications Act of 1996 directs FCC policy to accelerate the national deployment of advanced services, we believe policies that delay video entry also delay broadband deployment. For this reason, we believe that the FCC has an important role in encouraging broadband investments that jointly produce video and cable TV services.

Franchise Costs Resemble Taxes and are Borne by Citizens

While licensees pay the costs associated with franchising activities and obligations in the first instance, they are as a practical matter ultimately shifted to and paid, as all costs ultimately are, by citizens as consumers or shareholders. Imposition of such costs on licensees will be borne in part by owners of the franchisee and passed forward in part in the form of higher cable rates. The proportion is determined by the relative elasticity of supply and demand, with larger shares being passed through to consumers who are less responsive to price changes (those with less elastic demand).[24] The portion that is borne by owners will of course be reflected in part in the willingness of such owners to provide capital and thereby on the cost of capital.

As mentioned earlier, local franchise agreements routinely require cable operators to give free services, build institutional networks, provide free equipment, loans, scholarships, and planting trees. These requirements are especially wrongheaded in many cases since they involve taking money from endeavors that are leveraged in their ability to boost economic welfare more generally, such as broadband networks, and transferring it to less productive undertakings. By increasing the cost of cable and broadband services, consumers face higher prices. In effect, regulatory requirements act as a tax that reduces the demand for cable TV services and related network services such as broadband, thereby lowering consumer welfare. In evaluating the effects of LFA rules and requirements, the FCC needs to regard these activities as a tax that discourages consumption of cable TV and broadband services, and a cost ultimately borne by consumers.

Foregone Competitive Benefits are Costly to Consumers

A recent study by the Institute concluded that consumers are losing billions of dollars from overpriced cable TV services due to the lack of competition.[25] The study estimated that, over the next five years, consumers will pay $107 billion too much for cable TV services, with older consumers overpaying by $1,156 per household.[26] The Institute's study recognized that wireline competitors were trying to enter the market, but

[24] Joseph Stiglitz, Economics of the Public Sector, Ch. 17, "Who Really Pays the Tax: Tax Incidence" pp. 411-436. Methods for estimating the inefficiency created by taxes that raise prices see pp. 445-453. Norton NY 2nd edition, 1988.

[25] "An Analysis of Cable TV Services: Are Older Consumers Losing Out?" The American Consumer Institute, Reston, Va., October 17, 2005. The study is available at www.theamericanconsumer.org.

[26] As the early stage of competition develops in Texas, a state where statewide franchising is now permitted, the Institute will survey Texas consumers about the extent to which cable competition has resulted in lower prices. This survey is expected to be released within two weeks and will examine actual consumer benefits, instead of predicted consumer benefits as mentioned in these comments.

were facing potential regulatory roadblocks. While the study cites the historically high and increasingly higher price for cable TV services, recent reports indicate that cable price increases are continuing at alarming rates.[27] For consumers, these losses will never be recouped.

Build-Out Requirements May Reduce Consumer Welfare

In the increasingly competitive market for local video distribution (and broadband) services, firms will be impelled to construct and expand networks in ways that are economically rational and profit driven. To the extent that expansion plans are based on allocative efficiency considerations (serve highest value users first), LFA imposed build out requirements are not efficient. Worse, potentially, is the prospect that firms will be forced to build facilities which do not cover all relevant costs and thereby require subsidies from either other users and/or result in higher costs of capital which depend critically on the risk, earnings and growth profiles of the network.

Forcing firms to make "uneconomic" investments in pursuit of other nonmarket objectives is an artifact of protected monopoly market environments. Incumbent cable TV providers now pass most households in the U.S. and most have had decades to do so.[28] Requiring entrants to build out faster than financially rational adds a new risk for entrants that will raise the cost of capital and slow down the rate of new capital formation.

Economic theory tells us that consumers will benefit from competition. Making competition conditional upon costly requirements seems counterintuitive to encouraging consumer benefits. Based on a central theory in welfare economics, a goal of policymakers should always be to choose a policy that is a Pareto improvement over other policies. For example, if a cable TV competitor initially serves only one neighborhood in a community, and if a few consumers in this one neighborhood see some positive benefit from cable competition, total consumer welfare for community improves and is said to be Pareto optimal, because no consumer in the community was made worse off and some were made better off by competition. On the other hand, requirements that deter competitive entry will make some consumers worse off compared to unfettered competition, and are, therefore, not Pareto efficient.

Calls for Entry Barriers to "Level the Playing Field" Should be Rejected

It is difficult to resist arguments for entry barriers based on the need to "level the playing field" between incumbents and entrants. Nevertheless, the Commission should do so and evaluate all such claims carefully, since most are counter to the requirements of

[27] For instance see, "Comcast: 2006 Basic Video Price Increases Running at 6.7%; Flattening the Supply Curve," Bernstein Research, December 16, 2005.
[28] Using the Warren Fact Book, the FCC could go back decades and estimate the length it took to pass the vast majority of homes. In a limited sample, the Institute found that cable incumbents took 15 to 20 years to build out their networks. That would suggest that policies imposing strict build out requirements on competitive entrants should be avoided, since they would pose significant barriers to entry.

national policy to promote broadband investment and competition in markets for MVPD services.

First, most requirements responsive to the need to level the playing field involve imposing costs on entrants, which, as argued above, discourage investment and are ultimately borne by citizens.

Second, circumstances are markedly different today vis-à-vis the time when incumbent MVPD service providers were licensed. Incumbents were awarded monopoly franchises and conditions were imposed as efforts to capture some of the monopoly rents for citizens. Many of the conditions imposed on the original licensee were regarded as a quid pro quo for the grant of a monopoly. However, the situation today is one of allowing and promoting new entry as a means of eliminating monopoly rents and, to the extent that competition in MVPD markets is successful, there will be no monopoly rents for entrants to "share" with citizens.

Third, many of the costs imposed initially on incumbent MVPD providers were sunk costs that have been amortized and have no current bearing on market competition. The amortization of those sunk costs was absorbed in monopoly rents that are no longer likely to be available. Relatedly, whatever residual handicap to incumbents those might imply are substantially, if not totally, offset in the new competitive environment by first mover advantages associated with incumbency – brand awareness, an established customer base, familiarity with key competitive market characteristics, experience and others. These advantages translate to considerable value conferred, as it were, by citizens on incumbents and in the aggregate sum to more than any conceivable "burden" of incumbency to be offset by costs on rivals and raising entry barriers.

In short, it does not follow that the restrictions, requirements and costs initially imposed on cable franchisees should, as a matter of principle or pragmatism, be imposed on subsequent entrants. If the requirements imposed on initial franchises are viewed as "taxes" on monopoly profits, then they were simply a reasonable quid pro quo. That monopoly rationale no longer applies in the current competitive environment. And, under no circumstances, should the Commission allow entrants to face the replication of requirements that were uneconomic in the first place, as well as counter to clear national policies that promote broadband investment and competition.

Respectfully Submitted,

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